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AD VALOREM TAXATION OF REA COOPERATIVES

REA has been paying increased attention to the problem of ad valorem taxes on the property of its borrowers. Our studies indicate that in many cases the ad valorem tax burden is the most significant item of expense in the determination of the feasibility of a project.

In Ohio and in Wisconsin, where substantial allotments have been made in the past, a number of our borrowers were charged in 1938 with an ad valorem tax liability of over 15% and 20% respectively of the gross revenues for that year. This extremely heavy burden results from the improper and unlawful administration of ad valorem tax laws when applied to non-profit electric light and power companies serving relatively thin territories.

Ad valorem tax statutes provide that property is to be assessed at its true value, or actual value, or cash value, the variations in the standard of valuation being numerous. Seldom, if ever, does a tax law set forth definite criteria on the basis of which assessments may be calculated mathematically. Assessors and tax commissions are left without any statutory guides in valuing property and, in the case of electric light and power companies, without the benefit of sales of similar property in the open market.

Numerous factors affect the value of electric light and power company property, such as cost of construction, reproduction cost, gross and net earnings, nature of territory served, etc. All these elements must be given proper weight in the assessment of electric lines for tax purposes. Many assessors consider construction cost less depreciation as synonymous with assessed valuation. In so doing, they give no consideration whatsoever to the paramount factor, namely, earning power. The error of their ways is revealed in the following apt language of the Court in People v. Harris, 167 Misc. 585, 6 N.Y.S. (2d) 794 (Sup. Ct. 1938): "Would a railroad three hundred miles long, connecting two important industrial centers, and running through a prosperous and thickly inhabited country, be as valuable as one of the same length built in the wilds where but few people resided and where there was no industrial or business activity? Yet the reconstruction cost of the two roads would be substantially the same. To ask these questions is but to answer them."

In Great Northern Railroad v. Weeks, 297 U. S. 135 (1936) and in Parsons v. Detroit & Canada Tunnel Co., 92 F. (2d) 833 (C.C.A. 6th, 1937), the Courts emphasized that earning power "should be given primary and paramount weight" in assessing property for tax purposes and that to disregard this factor would violate the constitutional rights of the taxpayer under the 14th Amendment of the Federal Constitution.

Since our cooperatives do not have any net income, after setting up proper reserves for the debt service on the government loan and for future maintenance, (and it must be noted that this condition is not necessarily due to the non-profit character of the enterprise nor to mismanagement, but to the relative thinness of the territory served) the question arises as to the proper me-

thod of giving an effect to earning power in arriving at a valuation for tax purposes. Since there is no net income to be capitalized, a literal application of the rule of the above cases would result in no value at all. This, however, is an extreme application of the doctrine which would not seem to be justified. A number of court decisions point the way to a solution of this problem by emphasizing that assessed valuations for ad valorem taxes should be governed by the amount which a prudent investor would pay on a purchase of the property and that whatever property is worth for the purposes of income and sale, it is also worth for the purposes of taxation. See Adams Express Co. v. Ohio State Auditor, 165 U.S. 194 (1896).

The wide variations in assessments of electric lines result from the fact that valuations are basically matters of judgment with respect to which assessors are likely to differ. One suggested method of correcting this situation is by the substitution of a reasonable gross receipts tax in lieu of ad valorem taxes on the property of our borrowers in those states where ad valorem assessments and tax rates are completely out of line with the ability of our borrowers to pay. Wisconsin has very recently enacted such a measure. A gross receipts tax more accurately reflects ability to pay, is certain in its application, and leaves little room for differences of opinion among assessing officials.

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RECENT CASES

District Bonds - Substance and Procedure - Constitutionality of Legislature's Repeal of Statute Permitting Bondholders to Institute Suits in Name of District Against Defaulting Taxpayers.

Texas Improvement District issued bonds pledging all collections from taxes for payment thereof. A statute provided that if the board of supervisors fails to bring a suit for collection of delinquent taxes within 60 days from default, bondholders may institute such a suit in the name of the district. The statute was repealed some time after the execution of the bonds. Bondholder brings such a suit contending that the repeal violates state constitutional provisions guaranteeing due process and prohibiting the impairment of obligations of contracts. Held, the suit will lie. Atwood v. Kelley, 127 S.W. (2d) 555 (Tex. Civ. App. 1939).

The repeal of the statute deprived the bondholders of a substantive right, going far beyond a mere procedural change.

Evidence - Admissibility of Handbook of Bureau of Standards as Expert Opinion.

Municipality maintained electric wires in a manner stated by the Bureau of Standards in its handbook to be negligent. In an action for injuries resulting from plaintiff's contact with live wires, held that the Handbook is admissible as expert opinion, although a violation of its rule does not constitute negligence per se. Dothan v. Hardy, 188 So. 264 (Ala. 1939).

Mortgages - Who Can Attack Mortgage Authorized by Directors Without Shareholders' Consent Covering All Property of Corporation.

Defendant corporation was composed of two shareholders who were also directors. At directors' meeting, defendant corporation, following the mortgagee's instructions, authorized the execution of a mortgage covering all the property of a corporation. No shareholders' consent was shown. Both shareholders, who were also the directors, acted as individual sureties. Corporation went bankrupt. The trustee in bankruptcy and the mortgagee relying upon earlier decisions thought the mortgage invalid. Without the consent of the sureties, they compromised the mortgagee's claim, considering most of it as an unsecured debt. Mortgagee now sues sureties for deficiency. Held, no re

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covery. Atlas Finance Corp. v. Trocchi, 19 N.E. (2d) 722 (Mass. 1939). The court finds that even if the mortgage is valid, the mortgagee is estopped from so showing, for it was upon its direction that directors of corporation authorized the mortgage. If mortgage is valid, sureties are injured for they have the right to have mortgagee proceed against the property and then are subrogated to mortgagee's rights if property is not sufficient. By mortgagee's compromise with trustee, the sureties lost their right of subrogation. In a considered dictum, very close to a holding, the court also stated that the requirement of shareholders' consent is for the protection of shareholders and that a trustee in bankruptcy and creditors cannot raise the question of validity of a mortgage on that ground.

Municipalities - Authorization of Bond Issue for Construction of Electric Plant.

In 1932 City voted to issue bonds of $135,000 for the purpose of constructing a municipal light plant and distribution system. In 1937 the City entered into a contract with PWA whereby the City would issue bonds for $103,000 only, and PWA would make a grant of $84,000. A public utility, seeking to enjoin the issuance of the bonds by the City argues inter alia, that the issuance of bonds fo a lesser amount than $135,000 is unauthorized. Held, judgment for the City. Lake Superior District Power Co. v. City of Bessemer, 285 N.W. 20 (Mich. 1939).

The court states: "The issuance of a lesser amount of bonds is not contrary to the expressed will of the electorate. There is nothing...to prevent the city from taking advantage of the better proposition." Cf. Drummond v. Columbus, 285 N.W. 109 (Neb. 1939), (1939) I REA L.J. 56 where court held, inter alia, that where total cost of plant would be more than the amount authorized but where municipality would receive the excess in the form of a grant from the federal government, the issuance of the authorized amount of bonds would be enjoined.

Municipalities - Lapse of Time Between Election Authorizing Bond Issue and Proposed Issuance of Bonds.

Municipality in 1933 voted to authoriz issuance of revenue sewerage system bonds In 1939 it proposed to actually issue those bonds, and taxpayer brings suit to enjoin the issuance on the ground, inter alia, that an unreasonable length of time had elapsed between the authorization and the proposed issuance. The Louisiana Constitution and a Louisiana statute provide for a 60 day prescriptive period during which time attacks might be made as to the validity of the election authorizing the bonds or on the validity of the bond issue. Held, after the 60 days passed, no one could attack the bond issue, even though they were not issued for 6 years after their authorization. Henning v. Sulphur, 186 So. 845 (La. 1939).

Municipalities - Time of Fixing Valuation of Utility Property Acquired.

In 1933 Municipality elected to purchase property of utility, Wisconsin Statutes provide that Public Service Com-

mission shall determine amount of compensation to be paid for acquisition by municipality of utility property. Award of compensation was not made until 1936 by Commission which fixed value of utility property as of the date municipality elected to purchase the property. Held, Commission erred. The value of the property should be determined as of the time of taking of the property and not as of the time the municipality elects to purchase it. Wisconsin Power & Light Co. v. Public Service Comm., 284 N.W. 586 (Wis. 1939).

Municipalities - Ultra Vires - Negligence - Power of Municipality to Serve Consumers Beyond the Limits of the Municipality.

The court held that a North Carolina municipality has statutory authority to serve customers beyond the limits of the municipality, and that such statutory authority is requisite to the exercise of such power. The court further stated that the municipality would be liable for any injuries resulting from operation outside the city limits; if such service were ultra vires, no such liability would exist. Kennerly v. Dallas, 2 S.E. (2d) 538 (N.C. 1939).

Negligence - Maintenance of Electric Wires.

Defendant electric company had wires strung over some roads. The wires were not insulated and were very low. A workman while operating a steam shovel, found it necessary to pass under the wire. Since they were too low, he attempted to raise them to permit the steam shovel to pass below. The workman was electrocuted. Held, judgment for the Workman's administrator. Kentucky - Tennessee Light & Power Co. v. Priest's Adm'r, 127 S.W. 616 (Ky. 1939).

The defendant was negligent in the maintenance of the wires, and since the workman's action was completely normal and he had the right to assume that the wires were properly insulated, there was no contributory negligence.

Procedure - Attachment of Consumer's Deposit with Electric Company by Consumer's Creditor.

Consumer deposited $55 as security for payment of electric bills. His account with the company was still running, and all his bills had been paid. Judgment creditor of consumer seeks to attach the deposit as property of the judgment debtor. Held, the attachment will not lie. Parke, Davis & Co., Inc. v. Levine, 11 N.Y. S. (2d) 773 (City Ct. 1939).

The court states that until the closing of the consumer's account with the electric company it is impossible to say what amount, if any, would constitute the property of the consumer. The electric company is entitled to retain the money intact as security during the time service is being given. Therefore, though the deposit constitutes in one sense the property of the consumer, it is not his property within the meaning of the attachment statutes.

ADMINISTRATIVE INTERPRETATIONS

Electricity to Farmer's Cooperative - Taxability.

Where cooperative purchases wholesale power through a meter-checking station from a power company, the latter is required to pay the kilowatt hour tax. If the cooperative leases a generator from the wholesaler, the cooperative would probably be subject to the tax levied upon the generating and manufacturing of electricity for barter, sale or exchange. However, the Attorney-General refuses to pass on this latter question. Prentice Hall St. & Loc. Tax Serv. para. 50,004 (Op. Atty. Gen., Idaho, March 6, 1939).

REVIEWING THE LAW REVIEWS

Stanley, the Effect of Economic Depression Upon Foreclosure (1939) 27 Ky. L. J. 365.

Note (1939) The Law of Fixtures as Effected by the Relationship of the Litigants, 23 Marq. L. Rev. 136.

The writer divides the problem into three groups: (1) Landlord v. Tenant, (2) Conditional Vendor v. Subsequent Mortgagee, and (3) State v. Taxpayer.

Levin, Blind Spots in the Present Wisconsin General Corporation Statutes (1939) 1939 Wis. L. Rev. 173.

LEGAL MEMORANDA RECEIVED IN MAY

966. Priority as between after-acquired property clauses and purchase money mortgages.

967. Statutory regulation of finance charges in installment sale contracts.

968. Employers' liability under Arizona Employers' Liability Law as compared with liability under Workmen's Compensation Act.

969. Application of Wages and Hours Act to cooperative operating exclusively in one state except for the service of three members in another state.

970. "Domestic Lighting" and "Domestic Purposes" defined.

971. Necessity for re-incorporation of Georgia cooperative to permit service in non-rural area.

972. Liability of a cooperative when independent contractor erects transmission lines across property over which no right-of-way has been secured.

973. Means available for formation of an Alaska cooperative.

974. Requirements of election under Tennessee Municipal Electric Plant Act of 1935.

974a. Sufficiency of election resolution under Mississippi Electric Plant Act of 1936.

975. Evidence necessary to show "public need and public interest" before Alaska Public Works Board.

976. Summary of North Carolina Local Government Act with reference to municipal issuance of bonds.

980. Recordability of mortgage counterparts executed after execution of original mortgage.

981. Recommendation of changes in Tennessee mortgages and deeds of trust.

982. Requirements of Pennsylvania Cooperative to do business in Maryland.

983. Requirements of Pennsylvania Cooperative to do business in Maryland. (Emphasis on taxation)

984. Advisability of execution of installation notes rather than bonds by Nevada Power District.

985. Priority between mechanic's lien and mortgage lien in Pennsylvania including a discussion of Pennsylvania mortgage description law.

987. County underwriting of South Carolina projects.

988. Liability of Cooperative in tort where injury is caused by violation of Alaska Highway permits.

TAX MEMORANDA

T138. Federal and Minnesota Social Security Taxes.

RECENT STATUTES

CALIFORNIA

Moratorium Legislation Passed

A Chattel Mortgage, Mortgage and Trust Deed Moratorium Act declaring a moratorium upon foreclosures in some instances until July 1, 1940, and in others, until July 1, 1941, has been enacted. Mortgages held by REA are exempt from the moratory provisions of the Act by Section 21 which reads: "Nothing contained in this Act shall apply to or be deemed to affect: ...(c) Any mortgage or deed of trust while held and owned by the original lender securing any loan made by the United States Government or any agency thereof..." Calif. Laws 1939, ch. 86 (Approved April 24, 1939).

Taxing Agencies Authorized to File Bankruptcy Petitions

Act authorizes taxing agencies and instrumentalities to file petitions and prosecute proceedings under Secs. 81, 82, 83 and 84 of the Federal Bankruptcy Act - and ratifies all previous filing of petitions by such agencies and instrumentalities. Calif. Laws 1939, ch. 72 (Approved April 21, 1939).

Defaulting Irrigation Districts Made Subject to Securities Commission

Defaulting irrigation districts may, upon petition, become subject to the jurisdiction of the California District Securities Commission which shall then control the affairs of the district and determine the amount of assessments the district may levy. Calif. Laws 1939, ch. 125. (Approved May 9, 1939).

COLORADO

Short Form of Acknowledgment of Deeds of Real Property Prescribed

Colorado has enacted a statutory form of acknowledgment of deeds of real property. S.B. No. 401, 1939. (Approved May 2, 1939).

CONNECTICUT

Procedure Set Up for Determination of Value of Foreclosed Property

A procedure is set up for the appraisal of mortgaged property after foreclosure limiting the mortgage creditor in any further action upon the mortgage debt to the difference between the appraised value and the amount of the mortgage. Conn. Laws 1939, ch. 97. (Approved April 29, 1939).

DELAWARE

Improper Acknowledgments of Deeds Validated

H.B. No. 2, Section 1. (Approved April 24, 1939).

MARYLAND

Electrical Work Required to be Performed By Licensed Electrician

Statute provides that "...no electric light or power company shall attach its power lines or electrical meters to any consumer's property within the boarders of St. Mary's County unless the work has been installed by a Master Electrician Licensed under [The Act]" Md. Laws 1939, ch. 314 (Approved May 17, 1939).

MISSOURI

Blue Sky Law Amended in General Respects

S.B. No. 129 (Approved May 25, 1939)

NEBRASKA

Public Power and Irrigation Districts Authorized to Purchase Property of Privately-Owned Utilities

Amendment to Public Power and Irrigation District statutes authorizes such districts to purchase privately-owned electric utility systems with the provision that payment be made by the district to the municipality within which the utility is located of an amount equal to the amount of taxes formerly paid by the utility; the districts are also authorized to sell their property to other districts and municipalities. Bill No. 168 (Approved May 18, 1939).

After the purchase of a privately-owned utility, the district is subject to the disabilities and requirements for franchises to the same extent as the private utility acquired. Bill No. 170 (Approved May 18, 1939).

NEVADA

Chattel Mortgages Upon Stock in Trade of Merchants Specifically Authorized

Nev. Laws 1939, ch. 152 (Approved March 24, 1939).

OHIO

General Corporation Law Including Non Profit Sections Generally Amended

S.B. No. 47 (Approved April 24, 1939).

OKLAHOMA

Community Property System Established

Oklahoma is now the ninth state to have a community property system of ownership. H.B. No. 565 (Approved May 10, 1939).

SOUTH CAROLINA

Model Rural Electric Cooperative Act

S.B. No. 413 (Approved May 4, 1939)